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Report to Harold M. Williams, Chairman, Securities and Exchange Commission; by Elmer B. Staats, Comptroller General.

Issue Area: Energy (1600); Accounting and Financial Reporting (2800).

Contact: Energy and Minerals Div.

Budget Function: Natural Resources, Environment, and Energy: Energy (305); Miscellaneous: Financial Management and Information Systems (1002).

Organization Concerned: Financial Accounting Standards Board.

Congressional Relevance: House Committee on Interstate and Foreign Commerce; Senate Committee on Energy and Natural Resources.

Authority: Energy Policy and Conservation Act. Securities Acts Amendments of 1975.

A provision of the Energy Policy and Conservation Act requires that the Securities and Exchange Commission (SEC), with the involvement of the Financial Accounting Standards Board (FASB), develop accounting practices to be followed by oil and gas producers in reporting information to the Department of Energy. The SEC is seeking to determine whether a formal statement (Statement No. 19) issued by FASB on December 5, 1977, is appropriate for meeting the reporting requirements under the act and whether it should be followed for filing financial statements with SEC. There is a need for comparability in financial reporting by oil and gas producers which requires development of a uniform accounting standard. The SEC should select the most appropriate method to be used for preparing financial statements and should determine whether Standard No. 19 is appropriate. Concerns have been expressed about potential economic impacts of the statement such as effects on energy supply development and on competition within the industry. Although these impacts should be considered, the SEC's primary responsibility in developing the standards under securities laws is to provide information on which informed investment decisions can be made and that will facilitate the compilation of comparable and reliable information for policymaking. (HTW)



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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

AUG 04 1978

B-178726

The Honorable Harold M. Williams  
Chairman, Securities and Exchange  
Commission

Dear Mr. Chairman:

Since passage of the Energy Policy and Conservation Act, we have closely followed the efforts of the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) to develop accounting practices as required by Section 503 of that Act. Section 503 requires that the SEC, with the proper involvement of the FASB, develop accounting practices to be followed by oil and gas producers in reporting information to the Department of Energy (DOE). The Commission is required to consult with GAO, among others, as it develops its accounting practices under the Act.

Pursuant to our consulting role under Section 503 and our general oversight role we have monitored the activities of both FASB and SEC, and have submitted formal and informal comments at various times during the project. The FASB has now issued a formal statement based on its long review of the subject, and the SEC has completed an extensive file of its own on the adequacy of that rule. The issue now before the Commission is whether FASB Statement No. 19, issued on December 5, 1977, is appropriate for reporting to the DOE under the Act and, similarly, whether Statement No. 19 should be followed in preparing financial statements that are included in filings with the Commission under the securities laws.

While the responsibility for technical accounting decisions rests with the Commission, there have been a number of questions raised concerning the need for a uniform standard, the adequacy of FASB's efforts, and the role of certain national policy objectives in setting accounting standards. We believe our comments on these issues may be useful to you in making your decisions, and we offer them to you as a consulting agency under the Act.

EMD-78-100  
(00200)

NEED FOR UNIFORMITY  
AND COMPARABILITY

Several commentators have questioned the need for a single, uniform standard of accounting and reporting in the oil and gas producing industry. They often point out that producers differ in size, breadth of ownership, and diversity and offer these as reasons for using different accounting techniques. This group generally recommends that the Commission allow producers an open choice between the successful efforts and full cost accounting concepts.

We believe the standard-setting process should eliminate accounting alternatives where the facts and circumstances are the same. While oil and gas producers do vary in size, breadth of ownership, and diversity, these differences do not change the relevant facts and circumstances surrounding their exploration and production transactions and do not justify different accounting concepts. Certainly, the nature of the exploration and production business does not vary among producers to an extent that would justify both the successful efforts and full cost concepts.

We believe that a single, uniform accounting standard is long overdue in this industry and that the development of such a standard should be a principal goal of this project.

The Commission has long recognized the need for greater comparability in the financial data reported by oil and gas producers. The public record on this project contains evidence of the difficulties involved in comparing the financial statements of companies that use the successful efforts and full cost concepts. Policymakers have also been frustrated by the reporting diversity in this industry as reflected by the legislative mandate contained in Section 503 of the Energy Policy and Conservation Act. In reporting the bill out of committee on July 9, 1975, the House Interstate and Foreign Commerce Committee stated:

\*\*\*(an) analysis of Securities and Exchange Commission reports on publicly held companies indicates that financial reports required by that agency are inadequate for use as an energy data base.\*\*\* The SEC permits use of varied accounting methods by petroleum companies. The employment of 'full cost' or 'successful efforts' accounting methods result in particularly marked differences in stated profitability."

As part of a new energy data base developed partially in response to this Act, the DOE is proposing to collect financial statement information from oil and gas producers. While it is not yet clear just how DOE will use the information, its usefulness is jeopardized by the lack of a uniform accounting standard. Certainly, the credibility and reliability of industry-wide aggregations will be significantly impaired if the successful efforts/full cost controversy is not resolved.

We believe the Commission should resolve this issue by selecting the method that is most appropriate for preparing general-purpose financial statements. That standard should be followed for both investor reporting and DOE reporting under the Act.

### FASB PROJECT

We followed the FASB project in this area very closely. We served as formal observers of the FASB task force on the extractive industries, we attended the public hearings, and we obtained copies of all comment letters submitted to the FASB. We have reviewed the Board's entire public record on Statement No. 19. We believe the FASB did a commendable job of researching this difficult technical issue in a fair and independent manner and provided an adequate opportunity for interested parties to comment on the issues before issuing Statement No. 19.

We believe a private sector body like the FASB provides an appropriate format for developing accounting standards, and we concur with the Commission's policy under Accounting Series Release No. 150 of looking to the FASB for leadership in developing accounting standards. However, the Commission has the ultimate responsibility for accounting standards under the securities laws and may be required from time to time to evaluate issues previously studied and ruled upon by the private sector. In this particular instance the Energy Policy and Conservation Act places a specific responsibility upon the Commission to solicit written comments on whether the SEC should rely on the FASB's resolution. The Commission is required by law, therefore, to perform an oversight function, and to specifically accept, modify or reject Statement No. 19. While the FASB conducted a responsible study of this issue, the Commission should perform its oversight responsibility and determine whether, in its view, Statement No. 19 represents the most appropriate and meaningful accounting for this industry.

Whatever the Commission decides in this project, we believe it is important to point out the unique circumstances that

prompted the Commission's review of the FASB Statement, and to reaffirm the Commission's view of the private sector role in developing accounting standards. We do not believe that the exercise of SEC's oversight responsibility in this instance, regardless of its outcome, suggests that the FASB is any less vital or appropriate in its traditional role.

ROLE OF ECONOMIC IMPACT  
CONSIDERATIONS IN SETTING  
ACCOUNTING STANDARDS

A large number of commentators, including several Federal agencies, have expressed concern over the potential economic impacts of Statement No. 19 and have strongly urged the Commission to give considerable weight to these impacts in its evaluation of alternative solutions. Some have suggested that policy objectives such as energy supply development are overriding national priorities, and that no standard should be implemented that undermines these objectives. Others, including the U. S. Department of Justice, have voiced concern over potential adverse impacts on competition within the oil and gas producing industry and have stated that the Commission must choose the least anti-competitive alternative available.

From our review of the laws governing the Commission's development of accounting standards, we believe that many have overstated the weight that the Commission must give to antitrust and supply objectives in setting accounting standards. We agree that the SEC should consider the potential economic impacts of alternative solutions, but we do not believe the Commission is required to select the least anticompetitive method available or should support an accounting method that it feels is inadequate for investor reporting regardless of its potential usefulness in accomplishing national policy objectives such as energy supply development.

We believe the Commission's primary responsibility in developing accounting and reporting standards under the securities laws is to provide information on which informed investment decisions can be made. Under the Energy Policy and Conservation Act, standards are to be developed that will facilitate the compilation of comparable and reliable information for public policy-making. In our view, promoting competition within a particular industry and stimulating energy supply development are not objectives of the standard-setting process. We believe the Commission would be justified in focusing its attention primarily on the usefulness of the various alternatives in informing investors and policymakers, and weighing other policy concerns into its analysis as secondary considerations.

The Securities Acts Amendments of 1975 clearly recognize that competition issues are secondary considerations and give the SEC the authority to adopt rules that are burdensome to competition as long as the Commission determines that the burden is necessary or appropriate in carrying out its responsibilities. If the Commission concurs with the basis used by the Board in selecting among the alternatives in this case (see the "Basis for Conclusions" section of Statement No. 19), and the Board's conclusion that successful efforts is the best method using that basis, we believe the record supports a conclusion that the potential burden on competition as well as energy supply development is necessary and appropriate. If the SEC does not concur with the basis used by the Board or is less satisfied with successful efforts using that basis, then the potential economic impacts of Statement No. 19 may not appear as necessary or as appropriate. In any event, we feel the Commission's primary responsibility in this project is to provide a sound basis of reporting comparable and reliable information to investors and policymakers and that this objective should serve as the primary influence behind the Commission's decision.

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We hope these comments will be useful to you in your deliberations.

We are sending copies of this letter to the Chairmen, Senate Committee on Energy and Natural Resources and House Committee on Interstate and Foreign Commerce; and the Chairmen, Senate Committee on Governmental Affairs and House Committee on Government Operations.

Sincerely yours,



Comptroller General  
of the United States